

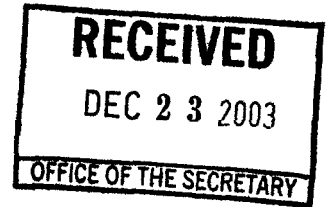
MMI

December 12, 2003

MILLCAP ADVISORS LLC

S7-19-03

Mr. Jonathan Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549-0609



Re: Security Holder Director Nominations (Release No. 34-48626; IC-26206; File No. S7-19-03).

Dear Mr. Katz:

I am President of Millcap Advisors, LLC, advisor to MMI Investments, L.P. ("MMI"), a fund with investments in small-capitalization public companies, which are significantly undervalued. As part of MMI's investment strategy, we undertake a pro-active relationship with the companies in which we invest. While it is our goal always to work cooperatively with existing managements and boards of directors, we rely on our ability to nominate and elect dissident directors to ensure the best use of our investors' capital in the management of a company. We therefore commend the Commission on its efforts to democratize director nomination and election procedures.

We are concerned, however, by the substance of the Commission's proposed rule "Security Holder Director Nominations," issued on October 14, 2003. While the proposed rule appropriately identifies the need for greater shareholder access to director nominations and elections, it does not go nearly far enough in remedying that need. Our primary concerns are the following:

- The proposed Trigger Events thresholds are too high to provide any substantial increase in shareholder access to director nominations and do not include underperformance of shareholder returns as a triggering factor. Furthermore, the proposed timing of trigger events and required hold periods renders this a longer process than many serious shareholders could undertake, while giving an underperforming management team longer to endanger the value of the shareholders' company.
- The eligibility standards requiring no relationship between nominating shareholders and their nominee(s) suggest a lack of recognition for how such a relationship can be highly beneficial to shareholders and logistically essential to selecting and running a dissident candidate. In this area we feel the Commission has mistaken indifference for independence.

Our views are guided by our experience as activist investors, corporate managers and dissident board candidates. It is this practical experience in the exercise of corporate governance and democracy which allows us to say that what has been proposed in rule 14a-11 is a good start, but only a start to meaningful regulations that will increase shareholders' ability to influence the management of their companies.

The following comments detail our views on the proposed rule:

3. What Events Must Occur Before a Company Would Be Required to Include a Security Holder Nominee in its Proxy Materials?

a. Nomination Procedure Triggering Events

The trigger requiring 35% of votes cast to be “withhold” votes, by the Commission’s own statistical analysis, would only be effective in 1.1% of companies. The theory of a “withhold” vote threshold is clearly logical, but it is difficult to imagine that eligibility for shareholder nomination in 1.1% of cases is the increased access goal of the Commission. Furthermore, the Commission’s data does not indicate how many of the 1.1% of elections wherein 35% of votes cast were withhold votes were in fact already contested elections. It is our belief that a significant percentage, if not a majority, of these elections were already contested by dissident shareholders on a non-management proxy – in which case dissidents have already gone to the effort and expense of producing a proxy and conducting a campaign making the increased access provided by this trigger too little too late. With reference to the Commission’s efforts to select a “still-substantial percentage” threshold, we recommend the choice be driven not by an arbitrary percentage of withhold votes, but rather by a decision from the Commission of how broad an impact this trigger should have and how great an increase in access the Commission wants.

The appropriate threshold for this trigger should relate to a target percentage of companies that should be eligible, and the corresponding number of withhold votes required to reach that percentage. We propose that the Commission’s target should be 15% of companies. Our belief is that the resulting threshold percentage of withhold votes corresponding to this target will be so low as to demonstrate the current lack of shareholder access and the importance of this trigger being reasonably attainable.

The trigger requiring the passage by 50% of voting shares of a “direct access proposal” is, we feel, a more appropriate trigger than the “withhold” vote trigger. Specifically, it properly bases passage on percentage of votes cast (versus votes outstanding) and makes appropriate demands on the shareholder submitting it (i.e. requiring 1% ownership for over a year), however such a process grants an existing board an additional year of stewardship, and a shareholder an additional year of disenfranchisement, despite the evidenced lack of confidence by a majority of voting shareholders. Furthermore, while the Commission’s data indicates that **84%** of public companies have at least one institutional investor which has held at least 1% of the outstanding stock for at least a year, the data does not reflect what percentage of companies has a 1% shareholder who has held for the two years required to see opened elections arise from their direct-access proposal, let alone one who has held for the three years likely-needed to see any positive results from such an election. We believe the percentage would decrease significantly.

We also believe that whereas an essential factor in increasing access to elections is reducing the cost to a nominating shareholder, the use of a direct access proposal trigger would in essence create two costly campaigns: one to pass/defeat the access proposal and another to elect/defeat

the dissident nominee(s). Furthermore, whereas the reward to the shareholder for winning the first campaign is the expense of a second one a year later, the reward to the company for winning is avoiding the expense of a second campaign – giving the company the incentive to outspend the dissident, aided by their existing advantage in accessing company funds for their campaign.

We appreciate the Commission’s consideration of other trigger events. In particular, we believe lagging shareholder return performance is arguably the best possible trigger event as it bears wholly and completely on the one issue affecting all shareholders equally: the performance of their investment. We also cite the Harris Interactive poll “Views of Corporate Governance” conducted for the American Federation of State, County and Municipal Employees and presented on **9/23/03** (exhibit to the AFSCME’s **9/24/03** letter to the Commission, posted on the SEC site at <http://www.sec.gov/rules/proposed/s71903/gmcentee092403.pdf>). This poll found **72%** support for both reform proposals in general and for nomination process reform proposals “if the corporation’s financial performance declines significantly compared to other corporations in the same industry.”

We propose that the final rule include a trigger event based on a simple negative comparison of the company’s stock performance on a trailing three-year compounded basis to the performance of the most comparable benchmark cited by the company in its last three proxy statements if available, otherwise chosen when possible based upon the company’s peers as defined by the investment community and represented in the coverage universe of Wall Street research analysts covering the company, and finally if necessary, by a benchmark chosen by a committee of independent members of the company’s board, which benchmark shall not change.

Generally speaking, we do not feel that a trigger event should be necessary at all. The proposed access does not automatically elect a dissident director – it merely enables one to be nominated on the company proxy. We submit that the nomination by a significant long-term shareholder (for example, one with 5% of the outstanding stock for at least one year) in itself represents a fair threshold for a trigger event. We also agree with the proposed immediate trigger upon nomination by a 10% holder (irrespective of hold period) as suggested by the Harvard Business School/Harvard Law School ad hoc group on the study of corporate governance in its **12/3/03** comment letter to the Commission. The trigger events as proposed enable an unsatisfactory board to insulate itself further from shareholders for the period of a year. If the purpose of the trigger event is to promote better governance by means of a “shot across the bow” of the existing board, then we believe the promotion of good governance is better and faster served by actual, immediate democratic governance, i.e. accelerated open elections.

5. Which Security Holders or Security Holder Groups May Submit a Nominee that the Company would be Required to Include in its Proxy Materials?

a. Proposed Eligibility Standards

We believe that the requirement that a nominating shareholder have 5% of a company’s outstanding stock for at least two years, or that a group aggregate 5% for over two years, demonstrates a lack of consistency in the proposed rule and a complete misunderstanding of the

universe of shareholders willing to seek such a nomination and the behavior and attitudes that govern the institutional investor universe in general.

The Commission's data indicates that 42% of public companies have a shareholder who meets this threshold alone, and 50% have two or more 2% shareholders who have held their stock for at least two years. The assumption however that this percentage represents in any way the universe of potential nominating shareholders belies three characteristics of the culture of institutional shareholders: 1) the great majority of shareholders believe that engaging in shareholder activism (such as the nomination of dissident director candidates) will lessen if not end their ability to access management in all companies in which they are invested; 2) the great majority of shareholders will never aggregate their holdings with another shareholder no matter how great the motivation for fear of exposing themselves to liability for the actions of another party; and 3) the larger the assets under management of the shareholder, the greater the likelihood they will meet the 5% and two year threshold, but the less likely they will be to incur the risks of activism due to the obligations, potential liabilities and institutional bureaucracy that are inherent in larger organizations.

While these are behavioral characterizations, we believe that these characterizations would be statistically borne out if the Commission followed the following steps. For instance, while **42%** of companies may have two-year 5% holders, were the Commission to cross-reference that data with the number of those holders who have engaged in activism in any form in any investment wherein they met the threshold (e.g. shareholder proposals, withhold votes, 13D filings (following the advent of form 13G), public letters to the board) we believe the percentage would be significantly, perhaps infinitely, lower. While investors have the ability to aggregate their shareholdings in the support of shareholder activism, we believe that were the Commission to cross reference those two-year 2%+ holders with those that have ever voluntarily aggregated their holdings with another shareholder (let alone one of comparable size), in the service of shareholder activism or otherwise, again the percentage would decrease significantly. Finally, were the Commission to take that first percentage of all shareholders who have ever engaged in activism in a company wherein they had held 5% of the stock for two years and compare those shareholders on a per capita as well as a capitalization basis with the overall universe of 5% shareholders in any company, the former would represent a miniscule fraction by both calculations.

We believe that there is an inconsistency in the requirement that a shareholder have 1% of the outstanding stock to submit a direct access proposal, but 5% to exercise the rights granted by passage of that proposal. The differential implies that even the shareholder who submits the direct access proposal cannot participate in the nominating process unless he/she already holds 5% (due to the two-year holding requirement, i.e. even if a 1% shareholder were to buy an additional 4% of the outstanding following the passage of their direct access proposal, they likely could not hold that 5% long enough to participate in the nomination process). As such, unless the 1% shareholder has already colluded with an existing 5% holder, or aggregated holdings with holders representing **4%** more of the outstanding stock, there is no incentive for the 1% holder to submit, let alone campaign for the direct access proposal.

As with our earlier objection to the timeline contemplated by the trigger events, the mandatory two-year hold period of a 5% holder is, we believe, an extraordinary hurdle to achieve in a company, which likely has underperformed to the degree that would encourage a board contest. Were the Commission to analyze its data to find how many companies with two-year 5% shareholders also had negative returns as defined in our proposed trigger event above, we believe this percentage would also be significantly lower – i.e. large investors tend to “vote with their feet” and requiring them to remain on a sinking ship for at least two years before they can affect management and three years before they are likely to see any benefit is an additional obstacle to the effectiveness of the proposed rule.

We also urge the Commission to include in the final rule a provision whereby shareholders who have previously filed their ownership on Schedule 13D would not be forbidden from changing their filing status to Schedule 13G in order to participate in rule 14a-11. We submit that certain shareholders, such as ourselves, with no inclination toward seeking a change in control may have filed Schedule 13D in the past due to their potential interest in seeking future representation on a company’s board. Prior to the proposed rule, there was no other procedure by which to seek such representation. As such, we feel that an explicit exemption for Schedule 13D filers to amend their status in order to participate in rule 14a-11 and seek board representation without a change in control is warranted.

6. What are the Requirements for the Person whom the Eligible Security Holder or Security Holder Group May Nominate?

b. Prohibited Relationships between the Nominee and the Nominating Security Holder or Group

The prohibition on relationships between the nominating shareholders and the nominees is impractical and inconsistent with the principals of good governance and alignment of interests.

The concern that a director candidate not be a “special interest” or “single-issue” director is misplaced and overstated. Even a director whom one would attempt to label as “special interest” would cease to be considered as such were he/she elected by a plurality of the shareholders – the special interest in such a case is clearly the general interest as well. Likewise, were the shareholders to elect a “single issue” director, there could be no greater endorsement of the importance of that single issue to shareholders’ interests. We echo the feelings expressed by the Harvard Business School/Harvard Law School ad hoc group on the study of corporate governance in its 12/3/03 comment letter to the Commission regarding the proposed rule:

- Critics of the Proposed Rules argue that shareholder access may lead to “special interest directors, balkanization of the board, and adversarial relationships within the board room. We do not believe these fears to be warranted. It is important to remember that the Proposed Rules still require each successful candidate to receive a plurality of the votes cast. While it is possible that special interest candidates may be nominated under the Proposed Rules, these candidates will not win unless they can appeal to a substantial fraction of the shareholders. Finally to the extent that a new board member who has received support from a shareholder plurality causes adversarial relationships within the

boardroom, we believe that this tension would most likely be productive rather than destructive.

In limiting the number of shareholder-nominated directors to **22%** of the board at most (in the case of a 9-person board) the Commission has in fact already assured that even if a director were elected based upon a special interest or single issue, those directors would not be empowered to enforce that special interest against the will of the board as a whole.

The Commission has also not demonstrated why it logically follows that a) the lack of a relationship between the nominee and nominating shareholder should ensure the nominee has no special interest, or that b) a relationship between the nominating shareholder and the nominee implies a special interest injurious to other shareholders. We believe that the lack of a relationship between the nominee and the nominating shareholder in no way ensures the lack of a special interest or single-issue represented by the nominee. It is more likely in fact that a nominee, unmotivated by a financial interest in the appreciation of the company's stock such as might be provided by the nominating shareholder (at no expense to the company, mind you), would require motivation from an ideological interest and the opportunity to advance his/her platform. For example, a union pension fund, unable to incentivize a highly-qualified, non-partisan director candidate, would need to secure a candidate willing to accept the work and liability of such an undertaking for another reason – one likely candidate would be one with a strong pro-labor interest.

Not only does a relationship between nominee and nominating shareholder not heighten the risks involved, it is in fact more likely to align the interests of the nominee and all shareholders. The requirements governing independence from the company for the nominating shareholder imply that the only direct financial interest between them will be the value of the shareholder's stock. It follows, therefore, that the most likely form of compensation from a shareholder for a nominee will be directly related to appreciation in the share price. This is alignment of interests with ALL shareholders. This is also good governance – founded in the same principals that prescribe stock-based compensation and ownership requirements for management and directors. Such a relationship is also, in spite of alarmist concerns from the Business Roundtable, far more independent than a director candidate unrelated to his/her nominating shareholder, whose only compensation will spring from the company itself.

The impracticality of securing a nominee without the ability to draw on one's business relationships and without the ability to compensate the nominee in a manner directly related to appreciation of the company's stock price, virtually ensures that a nominating shareholder will be unable to secure a qualified nominee. Securing a dissident candidate for a proxy contest is an extremely difficult task already. When one considers the effort and liability associated with such a campaign, the likelihood of a qualified candidate accepting such an undertaking without any relationship (and associated compensation) from his/her nominator is minute at best. **Speaking from experience at running dissident candidate slates, I can assure you that the rule as proposed will result in virtually no change in shareholder access to director elections.**

We recognize that there are relationships between the nominee and the nominating shareholder that could be potentially inappropriate. Therefore, we propose the final rule restrict only relationships between the parties wherein a shared financial interest related to the company

in question is not based solely on appreciation of the company's stock price. Requiring the nominating shareholder and the nominee to certify that this is the case should ensure their compliance. We believe such a rule would both discourage special interest candidacies and encourage alignment of interests between the nominee and all shareholders.

7. How Many Security Holder Nominees Must the Company Include in its proxy Materials?

a. Proposed Limitation

We submit that if the Commission's intent is truly to effect changes in shareholder access to board elections and composition while not allowing change of control, the number of security holder nominees could still be at least double the proposed numbers in all but the smallest boards (below 4 members).

9. What Must the Company Do after It Receives a Notice from a Nominating Security Holder or a Nominating Security Holder Group under Proposed Exchange Act Rule 14a-11?

a. Proposed Procedure

Regarding the Commission's proposed procedure governing supporting statements in proxy materials by shareholder nominated candidates, we feel that two revisions to the proposed rule are required for it to be fair:

1. While the company has the option to include supporting statements of any length for its own candidate(s), the proposed rule limits the shareholder nominee(s) to 500 words. The shareholder nominee supporting statement must be given equal voice with the company, either by means of a mutual limit or the advance notice of its intended statement size in support of its candidates by the company to the nominating shareholder or nominee.
2. The proposed rule allows a supporting statement for shareholder nominees only if the company comments directly for its own candidates or against the shareholder nominees. We submit that the company can endorse and advance its own candidates in the proxy materials without commenting directly on them and triggering the shareholder nominee's right to a supporting statement. Furthermore, if it is the Commission's intent that 14a-11 have "a similar underlying purpose as Exchange Act Rule 14a-8," then it would seem appropriate that like 14a-8, 14a-11 ought to include the guaranteed right to a supporting statement.

Regarding questions 1.2. and 1.3., it would be unreasonable and unfair if the final rule were not to include procedures which prescribed under reasonable time frames a) the means by which a company should seek to gather information additional to that included in the notice that is reasonably necessary for the company to make its determination regarding inclusion of a security holder nominee in the company's proxy, b) a method for a company to obtain follow-up information after a nominating security holder or nominee submits an initial response to a

request for information, and c) a mechanism for the nominating shareholder to attempt to cure the company's objections in a rejected nomination. Such procedures would mirror the fair and practical standards and procedures followed by the commission itself in the review of dissident proxies.

I thank you for the opportunity to comment on the proposed rule and would welcome any follow-up discussion with the Commission. I can be reached at (212) 586-4333 or bryant@millcap.com.

Sincerely,


Clay Lifflander
President

Cc: Peter Derby